— HEARING PANEL REPORT —

ADDRESSING MILK MOVEMENT ISSUES CONTAINED IN THE
MILK POOLING PLAN FOR MARKET MILK AND THE
STABILIZATION AND MARKETING PLANS
FOR NORTHERN AND SOUTHERN CALIFORNIA
BASED UPON A PUBLIC HEARING HELD ON

JUNE 4, 2003

This Report of the Hearing Panel regarding proposed amendments to the Milk Pooling Plan for Market Milk (Pool Plan) and to the Stabilization and Marketing Plans for Northern California and Southern California (Stab Plans) is based on evidence received into the Department of Food and Agriculture's hearing folder. The folder includes the Departmental exhibits, written statements and comments received from interested parties, written and oral testimony received at a public hearing held June 4, 2003, and written post hearing briefs.

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Introduction and Witnesses

The Department held a public hearing on Thursday, June 4, 2003 in Sacramento. The hearing considered amendments to milk movement incentives, namely, transportation allowances and transportation credits, as provided in the Milk Stabilization and Marketing Plans for Market Milk (Stab Plans) and the Pooling Plan for Market Milk (Pool Plan). The Department called the hearing after receiving a petition from Land O'Lakes (LOL). After the receipt of that petition, an alternative proposal was received from Milk Producers Council (MPC) prior to the deadline for submission of alternative proposals.

Hearing Witnesses:

A total of eleven witnesses/organizations testified including the Department's witness.

1. Cheryl Gilbertson — CDFA
2. *James Gruebele — Land O' Lakes
3. *Geoffrey Vanden Heuvel — Milk Producers Council
4. *William Schiek — Dairy Institute of California
5. *Gary Korsmeier — California Dairies, Inc.
6. *Steve James — Swiss Dairy
7. Michael Marsh — Western United Dairymen
8. Tiffany LaMendola — Western United Dairymen
9. James Dolan — Driftwood Dairy
10. *Francis Pacheco — Dairy Farmers of America
11. *Sharon Hale — Crystal Cream and Butter

An "*" indicates witness/organization who submitted a post hearing brief. In addition, written submissions were received from six people/organizations who did not give oral testimony:

12. Joe Maruca — Imperial County Board of Supervisors
13. Ed McGrew — Nudairy One
14. Robert Horton — public citizen, retired Pooling Branch Chief
15. Paul Bikowitz — Santee Dairies
16. Stephen Birdsall — Imperial County Agricultural Commissioner
17. Gary Stueve — Dairy Marketing Services

Attachment A–1 summarizes the panel's recommendations and arguments.
Attachment A–2 summarizes the testimony, written statements and post–hearing briefs.

General Analysis and Discussion of Issues and Proposals for Milk Movement Incentives

Background

In August 1999, the Department published a paper entitled "*Options to Facilitate Orderly Movement of Milk to California's Fluid Markets*" (Hearing Exhibit #7d). During 2000 using this paper as a starting point, the Department held a series of four industry workshops that attempted to review fully all aspects of milk movement incentives. A primary objective of the workshops was to try to reach a consensus on potential changes to the structure and scope of the milk movement incentive program. The workshops concluded without industry consensus; rather, the participants urged the Department to consider reviewing the unresolved issues at two public hearings that were held June 28 and July 2, 2001. These hearings resulted to changes to the transportation allowances in the Pool Plan and to both the transportation credits and call provisions in the Stab Plans (Hearing Exhibit #56b).

Transportation Allowances: What they are and how they work — When the Milk Pooling Plan was instituted in 1969, location differentials were established to provide producers with economic signals to move milk to designated counties. Location differentials were added to or deducted from quota payments to producers and were determined by the location of the plant that first received the milk. When milk was moved to designated counties, favorable location differentials offset the added cost of transporting milk.

As California milk production began to increase, overbase milk became an increasingly larger share of the total milk production. As a result, location differentials based solely on quota milk were no longer an efficient means of ensuring that adequate milk supplies would be made available to Class 1 plants. Consequently, location differentials were discontinued and a system of "transportation allowances" and "regional quota adjusters" (RQAs) were used as a means of ensuring the Class 1 plants were served.

Transportation allowances partially "incentivize"[1] those producers who are supplying milk to higher valued usage. These allowances apply to all market (grade A) milk moving from dairy farms to plants in qualifying areas that process more than 50 percent of the milk received into Class 1, Class 2, and/or Class 3 products. In addition, cooperative organizations receive transportation allowances on shipments to their plants if the plant is located in a deficit area and if the plant supplies 40 percent of its receipts for Class 1 usage.

[1] "incentivize" - to offer incentives or an incentive to; motivate.

Transportation Credits: What they are and how they work — In 1981, transportation credits were introduced to reduce the cost of plant–to–plant shipments. At one time, milk marketing areas in California were more numerous, and differences in hundredweight prices among milk marketing areas were sufficient to cover the cost of moving milk from one processing plant to another. However, with marketing area consolidation, these price differences were no longer capable of covering the cost of interplant shipments.

Transportation credits offset some of the cost of hauling milk assigned to Class 1 usage from plants in designated supply counties to plants in designated deficit counties. Handlers located in designated supply counties may deduct a specified transportation credit from applicable minimum prices for bulk market milk and bulk market skim milk shipped to a plant located in a designated deficit county. Shipments of condensed skim milk and market cream are not currently covered by transportation credits.

Regional Quota Adjusters: What they are and how they work — While Regional Quota adjusters (RQA) do not provide any direct incentive to move milk to Class 1 plants, they relate to a basic principle of location economics. Most Class 1 plants are located in or near the major population centers for economic reasons. Under normal conditions, Class 1 plants attract the nearest milk supply over more distant rural milk production areas. As a consequence, milk produced in close proximity to processing plants has more value.

RQAs, which with transportation allowances replaced location differentials, follow this economic principle. RQAs are deducted from the quota payments to producers and are determined by the geographical location of the producer's dairy. RQAs apply to the hundredweight equivalent of quota milk produced. Presently, these rates range from 5¢ per hundredweight for dairy farms located in North Coast counties to 27¢ per hundredweight for dairy farms located in Fresno, Kings, and Tulare counties. There are no RQAs assigned to dairy farms located in the southernmost part of the state.

Call Provisions: What they are and how they work — Milk movement requirements, commonly referred to as "call provisions", were instituted in 1979. They function by bestowing a ranking system for quota milk use when milk supplies are insufficient to meet the demand for fluid milk. Basically, call provisions require that manufacturing plants participating in the pool (i.e., plants receiving milk entitled to the quota price) must make a portion of the milk received available to plants processing Class 1 dairy products upon request. Because call provisions allow fluid plants to request milk from manufacturing plants, the impact of producer shipment decisions are mitigated. In other words, it does not matter to which plant a producer ships milk; call provisions give qualifying Class 1 plants the ability to obtain milk from manufacturing plants when it is needed.

More complete discussions of transportation allowances, transportation credits, regional quota adjusters and call provisions can be found in the Departmental publication, "*Options* *to Facilitate Orderly Movement of Milk to California's Fluid Markets*" (Hearing Exhibit #7d).

Summary of Proposals

Transportation Allowances – *Four Proposals*
Land O'Lakes - Southern California Receiving Area
- Make Riverside county a part of the receiving area
- Establish a three tier set of supply counties, instead of the current single set of allowances and brackets from all source counties
- No changes to the allowances for milk from Central California
- Reduce the allowances to a single rate of 22¢ per hundredweight for all shipments over 89 miles for milk from Southern California
- Eliminate the allowances for milk from Northern California

Milk Producers Council - Statewide
- Eliminate the concept of receiving areas and designate all Class 1, 2 and 3 plants as qualified plants for transportation allowances
- Make all grade A milk production eligible
- Prorate the allowances based on the percent of Class 1, 2 and 3 usage in the receiving plant
- Set six mileage brackets approximately every 25 miles out to 125 miles

California Dairies, Inc - Bay Area Receiving Area
- Increase the allowances for all mileage brackets by 4¢ per hundredweight

Dairy Farmers of America - Solano Receiving Area
- Increase the allowances for all mileage brackets by 4¢ per hundredweight

Transportation Credits – *Three Proposals*
Land O'Lakes - Southern California
- From Tulare county plants to San Diego and Riverside county qualifying plants, credits of $0.74 per hundredweight for bulk milk and $0.80 per hundredweight for condensed skim
- From Tulare county plants to Ventura, Los Angeles and Orange county qualifying plants, credits of $0.66 per hundredweight for bulk milk and $0.72 per hundredweight for condensed skim

Milk Producers Council - Statewide
- Set the combination of the area Class 1 differential and the transportation credit at no more than the applicable transportation allowance rate associated with the distance traveled
- Apply to all qualifying plants statewide

California Dairies, Inc - Southern California
- Eliminate credits for milk moving from Fresno and Kings counties to Southern California

Regional Quota Adjusters – *One Proposal*
Robert Horton - statewide

- Eliminate the current system of regional quota adjusters

Impact of Proposals

Both the analysis of the allowances and the credits were based on all proposals presented prior to the deadline for submission of alternative proposals. Prior to the hearing, MPC had proposed that allowances be prorated based on Class 1 usage; in their post hearing brief they proposed that allowances be prorated based on Class 1, 2 and 3 usage. CDI, DFA and Mr. Horton did not submit their proposals prior to the deadline for submission of alternative proposals.

The proposals were assessed using static analyses with monthly data from 2002. No assumptions were made regarding changes in milk movement patterns as a possible result of implementing any of the proposals. The "regulatory templates" generated by each proposal were overlaid on the milk movements that occurred in 2002, and costs were calculated accordingly. The cost of each proposal was compared to the cost generated by the current system on identical milk movements.

Transportation Allowances - The following table shows that both the proposal by MPC and the proposal by LOL result in a potential cost decrease to the pool, 17% for MPC and 28% for LOL (See Hearing Exhibit #6a for details of the analysis).

ANNUAL COST OF TRANSPORTATION ALLOWANCES
Current system compared to LOL and MPC proposals
Millions of dollars for 2002

	Current	LOL	MPC
Northern California	$3.84	$3.84	$4.95
Southern California	$8.08	$4.76	$4.97
Total	$11.92	$8.60	$9.93
% Change		-28%	-17%

Transportation Credits - The impact of the MPC transportation credit proposal was calculated using MPC's transportation allowance figures as the guideline. The following table shows that the proposal by MPC results in a potential cost decrease to the pool while the LOL proposal would result in cost increases to the pool. (See Hearing Exhibit #6b for details of the analysis).

ANNUAL COST OF TRANSPORTATION CREDITS
Current system compared to LOL and MPC proposals

Millions of dollars for 2002

	Current	LOL Estimate	MPC minimum
Northern California	$0.11	$0.11	$0.07
Southern California	$4.53	$5.83	$2.65
Total	$4.64	$5.94	$2.72
% Change		28%	-41%

At the prehearing work shop and in Hearing Exhibit #6b, the Department stated that the LOL proposal to make condensed skim eligible for credits would have increased costs to the pool by an additional $0.4 million for all of 2002. During the panel deliberations on how a credit could be implemented, it was determined that the credit for condensed skim would be handled differently than credits for bulk milk. Therefore, the $0.4 million figure was wrong. Please see the "**Concluding Remarks**" section at the end of this panel report for a better estimate of the cost of credits for condensed skim.

Analyses

Why Milk Movement Incentives are Needed — In 2000 at the first of the four Departmental workshops on milk movement incentives, the consensus of the participants was that a regulated system to move milk to the higher usages needs to continue to be in place. The group conceded that milk may move without a regulated system. However, one of the underlying tenets of instituting a pooling program in California was to ensure that Class 1 plants continue to be served in the absence of direct incentives for producers to ship their milk to those plants.

Since the inception of the pooling program, few significant changes have been implemented in the mechanisms used to "incentivize" those dairy farmers who are supplying milk to Class 1 plants. Consequently, there is no direct and compelling economic reason for a producer to ship milk to a fluid milk plant. In the late 1960s and early 1970s, this was not of concern because Class 1 utilization hovered near 65 percent of California's total milk production. Today, Class 1 utilization is less than 20 percent. More importantly, almost three–quarters of California's milk production is used to manufacture cheese, butter and nonfat dry milk.

To further compound the problem, many producers are paid premiums in addition to regulated minimum prices. These premiums include processing premiums offered by Class 4 plants; competitive premiums offered by Class 1, 2 and 3 plants; and the 13th check premiums offered by cooperatives. These premiums are not subject to pooling. The producers who ship milk to plants offering premiums receive both the appropriate pool price (quota, overbase or a blend of the two) plus the associated premium. The availability of these economic incentives may cause some milk production that would have been shipped to fluid milk plants to be diverted to manufacturing plants.

Southern California exemplifies the changing nature of milk market structure. Although Southern California has been traditionally viewed as a deficit market, that may no longer be the case. Previous hearing records are replete with definitions of a “deficit market”. Not surprisingly, the descriptions of a “deficit market” not only reflected the positions of the witnesses, but supported them as well. The definition for the term “deficit market” is not precise, but for the task at hand, a precise definition is not needed. Most recognize “deficit market” as a general term used to describe the conditions of a market vis-à-vis a “surplus market”. Nonetheless, the Panel puts forth its working definition of a deficit market to make a point about the use of transportation credits.

In the strictest sense, a market that has enough locally produced milk to satisfy its Class 1 needs plus a moderate reserve (20 to 25 percent) to account for fluctuations in demand and supply for Class 1 products is not deficit. In the case of the Southern California Milk Marketing Area, enough milk was produced in all of 2002 to serve all of its Class 1 needs and maintain a standby reserve of 160% fat and 54% SNF.

Nonetheless for all of 2002, dairy farmers incurred a cost of nearly $8 million dollars in transportation allowances and $4.5 million in transportation credits to bring milk from the South Valley to serve Southern California's Class 1 needs. In 2000, the cost to the pool had also been about $8 million for allowances and $3.0 million for credits. Milk produced locally does not necessary move to the fluid milk plants despite the quantity of milk that continues to be produced in the area.

During the hearing, one witness expressed some concern about the qualification requirements for plants receiving transportation allowances. Specifically, the question was, does the return to the pool more than offset the cost of offering transportation allowances to plants processing at least some the milk received into Class 2 and 3 products? To investigate this, we calculated the pool revenues contributed by using prices for Class 1 net of the higher of Class 4a or 4b prices and prices for Classes 2 and 3 net of Class 4a prices. These contributions were compared to the cost of transportation allowances and credits during 2002. The results of the comparison are summarized in the following table. The contributions of Classes 1, 2 and 3 to the pool far exceed the cost of the milk movement incentives. In fact, the contributions from Classes 2 and 3 alone more than offset the entire cost of the transportation allowances and credits during 2002.

Pool Income from Classes 1, 2 and 3 prices above Class 4 prices, compared to Pool Distribution for Transportation Allowances and Credits - Totals for 2002

	Income		Distribution		
Class 3	$9	Million			
Class 2	$10	Million			
Class 1	$148	Million			
			$5	Million	**TC**
			$12	Million	**TA**
TOTALS	**$167**	**Million**	**$17**	**Million**	

The Importance of Transportation Allowances and Credits - Milk movement incentives, whether they are transportation allowances or credits are extremely important to dairy farmers. It must be remembered that dairy farmers must incur the cost of shipping their milk to the plants, that the price is fob at the plant. As a result the allowances and credits impact the competitive environment upon which milk buyers (processors) compete for their bulk milk supplies. During a period of relatively low farm milk prices, their importance intensifies.

Obtaining new or higher rates for transportation allowances may mean the difference between remaining economically viable or failing as a dairy farm. There seems to be a growing interest in establishing new or higher transportation allowances. Moreover, many dairy farmers believe that if some farmers receive them, then all farmers should receive the same level of allowances.

Obtaining new or higher rates for transportation credits are extremely important to dairy cooperative organizations and fluid processors. The financial health of a cooperative organization that operates a processing plant can equally be impacted by the existence or level of transportation credits. The level of the credit may impact the competitiveness of a fluid processor.

The current market structure and the system of transportation allowance and credits have evolved over many years. Given the dynamics of the marketplace, it is necessary to review the appropriateness of the regulatory structure periodically. Over the years of their existence, the relative levels of transportation allowances and credits from the Southern San Joaquin Valley into the Southern California market has been somewhat contentious among cooperatives operating in the Southern San Joaquin Valley and in Southern California. Historically, transportation credits for plant-to-plant movement have applied only to milk and skim from Designated Supply counties to Designated Deficit counties. Condensed skim and cream shipments had been excluded from receiving this credit.

At the hearings, it was apparent that self–interest largely dictated the positions taken. However outside the hearing process, there has been a consensus among dairy industry stakeholders over the years on three basic criteria: (1) that the closest milk serve the higher class usage; (2) that the cost of the transportation allowance and credit be kept to a minimum; and (3) that those producers who are serving the higher usages be "incentivized". The Panel adopted these three criteria in evaluating the various proposals. Of course, other factors were considered as well.

Discussion and Recommendations for Transportation Allowances

Statewide Uniform Allowances

The basic tenets of the MPC proposal centered on producer equity issues: (1) all Class 1, 2, and 3 plants qualify for allowances (and all Class 1 plants for credits); (2) all Grade A milk production eligible to receive allowances; and (3) a uniform mileage bracket and rate structure statewide.

A review of the data demonstrates that there is considerable variation among the milk production and processing areas:

- the number of and volume processed by Class 4 plants;
- the number of and volume processed by Class 1, 2 and 3 plants;
- the number, size, and location of farms relative both to the Class 1, 2 and 3 plants and to the Class 4 plants;
- the rates charged producers for hauls from the farm to local, usually Class 4 plants (local hauls); the rates charged producers for hauls from the farm to more distant, usually Class 1, 2 and 3 plants (distant hauls);
- the processing premiums offered by Class 4 plants; the competitive premiums offered by Class 1, 2 and 3 plants; and the 13th check premiums offered by cooperatives.

A qualitative comparison of the Southern San Joaquin Valley and the Bay Area serves to illustrate this variation:

- *Southern San Joaquin Valley with a local milk supply*
    - Class 4 plants large and numerous;
    - Class 1, 2 and 3 plants average and few;
    - Farms large, numerous, and growing rapidly;
    - Class 1, 2, 3 and 4 plants all located relatively close to milk supply;
    - Local and distant hauls comparable and among lowest in the state; and
    - Premiums mainly competitive and 13th check.

- *Bay Area with a distant milk supply (North Bay and Northern San Joaquin Valley)*
    - Class 4 plants small to large and numerous;
    - Class 1, 2 and 3 plants large and numerous;
    - Farms small to average, numerous, and declining or growing slowly;
    - Class 1, 2 and 3 located relatively distant from milk supply, with Class 4 plants located relatively close to milk supply;
    - Local hauls variable ranging from low to high, with distant hauls variable but generally higher than local hauls; and
    - Premiums full range of processing, competitive and 13th check.

Even if the distances were the same, a blanket qualification standard for Classes 1, 2 and 3 ignores the fact that there are distinct differences in a plant's ability to attract adequate supplies of milk. Given the diversity between areas, establishing a statewide standard for allowance could result in providing too much incentive in one area and not enough in another area.

Finally, MPC focuses too narrowly on their perception of equity among producers. While the Panel recognizes the importance of producer equity, it should not come at the expense of attaining any of the three objectives on which there was general stakeholder consensus at the 2000 workshops:

(1) closest milk serves the Class 1, 2 and 3;
(2) minimizing the cost to the pool; and
(3) "incentivize" those producers who are serving Class 1, 2 and 3 markets.

The best way transportation allowance costs to the pool can be minimized is the establishment of specific rates that satisfy the unique characteristics of each area. Moreover, the concept of "incentivizing" farmers who serve the higher valued usage is not consistent with a fundamental definition of producer equity. However, in the Panel's view, attainment of the three objectives will be equitable to producers.

Panel Recommendation — Do not adopt the MPC proposal to extend transportation allowances to all Class 1, 2 and 3 plants and all Grade A milk.

Allowances for Southern California

Adjustments to Allowance Rates for Southern California

Based on the most recent pool data available (April 2003), 59% of the Southern California's milk production is being used in the production of Class 4 products, while 41% of the production is being used in the production of Class 1, 2 and 3 products. Consequently, much of the Class 1, 2 and 3 usages is being supplied by milk produced in areas outside Southern California.

The supply of milk in Southern California is currently more than adequate to meet all Class 1 needs. Yet in 2002, 1.6 billion pounds of milk were moved from Northern California to Southern California. The 1.6 billion pounds represents 17% of all milk utilized in Southern California and 31% of all Class 1, 2 and 3 usage. The majority of this milk received allowances or credits for a total cost of $12.6 million.

Additionally, the supply of milk in Southern California has been in decline for a number of years and the decline is accelerating:

CHANGES IN MILK PRODUCTION

	Northern California	Southern California
Average Annual 1992 to 2002	+6.0%	-0.2%
Average Annual 1999 to 2002	+6.6%	-3.4%
March 2002 to March 2003	+6.4%	-9.3% .

This decline in Southern California milk production will result in an excess of plant capacity in the area. When this situation occurred in Wisconsin, the plants paid premiums to attract local milk. Class 1 plants in Southern California could be faced with paying these competitive premiums in addition to the 27¢ they already pay above the Northern California Class 1 price. An allowance for the local milk in Southern California would help Class 1 plants offset these premiums.

If a greater proportion of the Southern California milk supply was used in the higher Class 1, 2 and 3 usages, then the total transportation allowance and credit costs to the pool would be reduced. An essential element in this dilemma is the fact that significant quantities of milk are being processed into Class 4 products in the Southern California area. This factor is atypical of the principals of general dairy economics. Typically, Class 1, 2 and 3 plants operate in the large urban areas in order to minimize transportation costs of from the plant to the consumer. Major Class 4 operations typically operate in the rural area in which milk supplies are the most plentiful. These plants operate in such large scale and because the finished Class 4 products have eliminated much of the fluid carrier portion of milk, they can transport the product more economically to a nationwide market.

When the transportation allowance system was first established, no transportation allowances were implemented in Southern California simply because it was not needed. Most of the processing plants were Class 1, 2 and 3 operations and there simply were few other alternatives that would attract the local production. Since 1986, there has been a large cheese plant operating in Southern California; this plant subsequently underwent a major explanation. In southern California since 1986, Class 4 utilization has doubled, going from less than a third of the milk utilized to nearly half.

The Southern California dairy farmers who are closer to a Class 4 manufacturing plant, or whom are able to qualify for premiums outside the pool, are financially better off if they ship their milk supplies to Class 4 plant rather than a Class 1, 2 and 3 plants. By establishing a transportation allowance in Southern California, it would provide some economic incentive for Southern California farmers to transport their milk into the Class 1, 2 and 3 plants.

Compounding the problem is the fact that the transportation (hauling) cost from the farm to the processing plant is the producer's obligation and no allowances are provided to producers within Southern California for hauling milk to the Class 1, 2 and 3 plants. It may be possible to address the concerns listed above by setting an allowance for the close in milk within Southern California. This potentially could attract local milk away from the Class 4 plants to Class 1, 2 and 3 plants. In Northern California all receiving areas have allowances of at least 9¢ for close in milk because of the closeness of competing Class 4 plants:

CURRENT TRANSPORTATION ALLOWANCES

Southern California Receiving Area	
From zero through 89 miles	0¢ per cwt.
Over 89 miles through 139 miles	43¢ per cwt.
Over 139 miles	58¢ per cwt.
Over 59 miles	12¢ per cwt.
Bay Receiving Area:	
From zero through 99 miles	20¢ per cwt.
Over 99 miles through 199 miles	24¢ per cwt.
Over 199 miles	30¢ per cwt.
Solano Receiving Area:	
From zero through 44 miles	11¢ per cwt.
Over 44 miles through 99 miles	16¢ per cwt.
Over 99 miles	21¢ per cwt.
Sacramento Receiving Area:	
From zero through 59 miles	9¢ per cwt.
Over 59 miles	12¢ per cwt.
Shasta Receiving Area:	
From zero through 29 miles	13¢ per cwt.
Over 29 miles through 49 miles	16¢ per cwt.
Over 49 miles	19¢ per cwt.

The Northern California standard (all receiving areas have an allowance of at least 9¢ for close in milk because of the closeness of competing Class 4 plants) may now need to be applied to Southern California. This is because the same pattern of competition exists in Southern California where 46% of the milk is utilized as Classes 4. Thus, it may now be appropriate to establish an allowance for the 0 to 89 mileage bracket.

Based on all the factors associated with each receiving area, the Panel determined that the Sacramento receiving area was the most comparable and appropriate basis for a starting point in establishing the Southern California allowance. This 9¢ allowance for the 0 to 59 mileage bracket is also the lowest rate in Northern California.

MPC proposed rates of, progressively, 5¢, 10¢ and 15¢ for three mileage brackets all less than 89 miles. However, the MPC proposal was not specifically designed for Southern California. These rates and mileage brackets were a part of MPC's proposal for a uniform, statewide set of brackets and allowances.

Therefore the panel chose as a starting point the lowest rate in Northern California: 9¢ for the 0 to 59 bracket in the Sacramento Receiving Area. The panel wanted to see how this allowance would compare both to the other Southern California allowances for 90+ miles and to the allowances in the other receiving areas.

Initially the panel compared the allowances to the difference between local haul rates and distant haul rates. However in several cases either there were no local haul rates

(San Jacinto and Santa Barbara) or the local haul rates seemed suspect (Barstow and North Bay). (See Hearing Exhibit #32a). To fill these gaps, the panel considered using standardized rates. The idea of using standardized local hauling rates was sparked by comments made by a hearing witness. **(See page 160: lines 17-24; page 174: lines 24-25; and page 175: lines 1-4 of the June 4, 2003 Hearing Transcript.)**

The standardized rates chosen were 23¢ and 30¢. The 23¢ and 30¢ rates are the local hauls, respectively, for the Southern San Joaquin Valley and for Los Angeles. They were chosen as representing the smallest and largest observed local hauls for any significant volumes of milk. The data for October 2002 were used instead of the more recent March 2003 because the latter reflected the spike in fuel costs associated with the second Gulf War (Hearing Exhibit #7i).

The incentive relative to the local haul that a 9¢ allowance would generate in Southern California is not that different from the comparable incentives in Northern California. For a standardized local haul of 30¢, the incentive for the closest in milk ranges from 8¢ to 15¢ for the current Northern California allowances. For the proposed 9¢ rate in Southern California, the incentive for the closest in milk ranges from 2¢ to 7¢, with a -1¢ shortfall for milk moving to San Diego from San Jacinto:

ALLOWANCE SHORTFALLS AND INCENTIVES
A Comparison using October 2002 Hauling Cost Data
Shaded areas represent Panel Recommendation

To / From	Transportation Allowance ($/cwt.)	Incentive or (Shortfall) [1/] Local = $0.30 ($/cwt.)	Local = $0.23 ($/cwt.)
Sacramento			
Northern San Joaquin Valley	$0.12	$0.08	$0.00
Bay Area			
North Bay	$0.24	$0.15	$0.07
Northern San Joaquin Valley	$0.24	$0.00	($0.07)
Butte, Glenn, Sutter & Yuba	$0.28	($0.05)	($0.13)
		-	-
Los Angeles			
Western Riverside & San Bernardino	$0.09	$0.07	($0.00)
San Jacinto	$0.09	$0.03	($0.04)
Riverside & San Bernardino			
San Jacinto	$0.09	$0.02	($0.06)
San Diego			
San Jacinto	$0.09	($0.01)	($0.09)

[1/] Incentive or (Shortfall) = Allowance - (Distant Haul - Local Haul)

A 9¢ allowance for close in milk may attract milk away from Class 4 plants, but unless it replaces significant quantities coming in at the 43¢ and 58¢ allowance or the 50¢ credit, it will increase the cost to the pool. However, it will "incentivize" those producers who are supplying milk to higher value usage.

Panel Recommendation — In the Southern California Marketing Area, for both the Southern California Receiving Area and the San Diego Receiving Area, increase the rate for milk in the 0 to 89 mile bracket from $0.00 to $0.09 per hundredweight, and leave the remaining rates and brackets unchanged.

Transportation Allowances for Riverside County

The amount of milk production in the Southern California area is sufficient to supply the total output of Class 1, 2 and 3 products produced by Southern California processing plants, and provide milk to process about a third of the current Class 4 products. (See table in the "**Discussion and Recommendations for Other Issues**" section.)

Interestingly, a significant amount of the milk processed in Southern California's is produced in San Bernardino and Riverside counties or shipped in from Kern, Kings and Tulare counties. The remaining Northern and Southern California counties make up a relatively small amount of the area's total supply. In April 2003, the actual pattern of usage of the two major Southern California supply counties reflected that 59% of the available supply was being used in the production of Class 4 products with 41% going into Class 1 usage.

All Handlers
Source and Utilization for April 2003
Millions of Pounds

	Kern, Kings & Tulare	Riverside & San Bernardino	Total
Class 1, 2 & 3	180	169	349
Class 4a & 4b	992	244	1,236
Total	1,172	413	1,585
Class 1, 2 & 3	15%	41%	22%
Class 4a & 4b	85%	59%	78%

Southern California's major Class 1, 2 and 3 processing plants are located in the Los Angeles, Riverside, and Orange counties. Despite their different county locations, all the plants compete in the same Southern California market.

About half of Southern California's Class 1, 2 and 3 plant needs was being supplied by dairy farms that are longer distances away from Southern California's fluid plants than the farms which are located in Riverside and San Bernardino counties. The shipments of the milk from the distant Kern, Kings, and Tulare counties to Los Angeles and Orange counties qualify for transportation allowances of 43¢ and 58¢ per hundredweight. Meanwhile the shipments from dairy farms in Riverside and San Bernardino counties into Southern California's Class 1, 2 and 3 plants do not receive transportation allowances.

The basic tenet of the LOL proposal was that plants in Riverside county compete for milk with other Class 1 plants in Southern California. However, while other fluid plants are eligible for both allowances and credits, plants in Riverside county are only eligible for credits. The continued existence of this policy may no longer be justified.

It is in the public interest to have as much of the locally produced milk as possible supply the higher valued product usage. In addition to minimizing the cost to the pool, it ensures a more efficient system. It also provides more appropriate "incentivization" to the farmers in San Bernardino and Riverside counties who are serving the higher valued usages (Class 1, 2 and 3).

Based on the data, it appears that the current system is not providing the appropriate incentives to achieve this goal. It is appropriate to include Riverside county as being eligible for transportation allowances especially now that the other Southern California counties will receive a 9¢ allowance for local milk. This will also tend to "incentivize" those producers who are supplying milk to higher value usage.

The addition of Riverside county to the Southern California receiving area combined with the 9¢ allowance for close in milk may attract milk away from Class 4a and 4b plants, but unless it replaces significant quantities coming in at the 43¢ and 58¢ allowance or the 50¢ credit, it will increase the cost to the pool. However, it will "incentivize" those producers who are supplying milk to higher value usage.

Panel Recommendation — Make Riverside county a part of the Southern California receiving area thus extending transportation allowances to all Class 1, 2 and 3 plants located there.

Allowances for Northern California

There was limited testimony and no prehearing analysis for the proposals to change the transportation allowance system in Northern California. The proposals submitted by CDI and DFA both requested increases in rates without any changes to the existing mileage brackets or adjustments to receiving areas. The proposal from CDI requested a 4¢ increase in all brackets for milk shipped into the Bay Area Receiving Area. The proposal from DFA requested a 4¢ increase in all brackets for milk shipped into the Solano Receiving Area. However, neither CDI nor DFA submitted their proposals prior to the final date for submission of alternative proposals for the prehearing workshop; neither made them available to the industry prior to the day of the hearing.

A hearing witness representing a Class 1, 2 and 3, processor in the Sacramento Receiving Area objected to both requests. Neither request had been submitted in compliance with the alternative hearing proposal deadline. No departmental analysis was completed and distributed at the prehearing workshop. Having no notice, the company was not able to analyze the impact of the proposals on their Sacramento plant's ability to attract milk. Therefore, the witness was not prepared to testify on the issue.

Using Hearing Exhibit #32a, the Panel compared hauling costs into the Bay Area for January 2001 and October 2002. The January 2001 data was used as that was the basis for the last changes in rates at the June-July 2001 hearing. The data for October 2002 was used instead of the more recent March 2003 because the latter reflected the spike in fuel costs associated with the second Gulf War (Hearing Exhibit #7i). The Panel was not able to confirm that hauling costs have increased by the amounts to which the organizations testified.

CDI did submit a copy of a hauling invoice as supporting evidence, but did not show how this invoice supported their proposal. DFA did file a post hearing brief with some justification of their proposal; however the brief was not in full accordance with the hearing regulations.

The purpose of the hearing regulations is to encourage as complete a record on which good hearing decisions can be made. In this case, the nature, manner, and timing of the requests were not conducive to obtaining a complete hearing record.

In summary, the proponents did not supply substantial and timely data on the need for the increase. A competing Northern California processor opposed the increase because, absent their submission prior to the hearing, it was not possible to analyze the impact on a Sacramento plant's ability to attract milk. The Department's hauling cost survey data did not confirm hauling costs increases.

Panel Recommendation — Do not make any changes to the transportation allowance system in Northern California.

Discussion and Recommendations for Transportation Credits

Credits for Bulk Milk: Southern California

Transportation Credits from Tulare to Los Angeles, Orange and Ventura

From 1983 through 1996, the Department adjusted the transportation credit whenever the plant-to-plant hauling costs changed. For those thirteen years, the transportation credit was determined by taking the cost to haul milk from the Southern San Joaquin Valley to Southern California, subtracting the Class 1 area differential (the differential between the Class 1 prices in Southern California and the Southern San Joaquin Valley, currently 27¢) and providing for a modest shortfall.

Historically, the shortfall ranged from 1¢ to 7¢ just after a hearing, and it was allowed to range from 4¢ to 9¢ before another hearing was called. From November 1981 through November 1996, the shortfall averaged 5.0¢. In March 2003 the shortfall was 18¢. However, because the 18¢ in March reflected the spike in fuel costs associated with the second Gulf War (Hearing Exhibit #7i), the October 2002 shortfall of 15¢ may be more representative of the current situation.

In its determinations following the June 28 and July 2, 2003 hearings, the Panel reexamined its historic policy. In evaluating the various proposals, of course the Panel maintained the three criteria developed in the 2000 workshops:

(1) that the closest milk serve the higher class usage;
(2) that the cost of the transportation allowance and credit be kept to a minimum; and
(3) that those producers who are serving the higher usages be “incentivized”.

However, other factors were considered as well, these included, but were not limited to:

(a) Hauling costs, Class 1 area differentials, and shorts falls.
(b) The sufficiency of local Southern California milk to meet Class 1, 2 and 3 needs.
(c) Available of milk supplies in closer locations that could supply the Southern California plants at lower hauling costs,
(d) Producers’ obligation to make available milk for Class 1, 2 and 3 purposes does not require subsidization of tailored milk shipments.
(e) Relative costs to the pool of allowances and credits for comparable quantities of finished product. (The Panel has not stated that the costs must be equal, only that the costs need to be compared as part of the decision process.)

Based on the three criteria and other factors including the five listed, the Panel recommended and the Secretary approved the denial of the request by LOL to increase the transportation credit to help offset some of the increased hauling costs.

At the current hearing, the proponents of increasing the credits argued that the Department should ignore the three criteria and all other factors except the traditional one of hauling costs, Class 1 area differentials and shorts falls. One proponent (LOL) even broke with the historical approach by asking for the elimination of shortfalls.

LOL cited the increase in transportation costs from Tulare county to Los Angeles, Orange, and Ventura counties and from Tulare county to Riverside and San Diego counties. They argued that there should be no short fall and that the transportation credits be raised from 50 to 66¢ to Los Angeles, Orange, and Ventura counties, and from 50 to 74¢ from South Valley to Riverside and San Diego counties.

LOL testified that plant-to-plant transfers are at a loss, that competition precludes charging more, and processing the milk in Tulare would be more profitable. LOL implied that the changes made by Department in the prior hearing did not change the basic pattern of milk movements.

Citing data for March 2003 for Southern California, LOL testified that:
- Only 53% of Class 1, 2 and 3 usage supplied by local shipments
- Plant-to-plant transfers had dropped from 2 million lbs/day high
- Out-of-state sources were almost twice that level.

Inherent in the arguments of all the proponents is that the Department's 2001 hearing decision provided no real changes to warrant making additional milk supplies available in Southern California.

LOL based some of it arguments on the most current month of data for sources of milk processed in Southern California (March 2003). However, it is more appropriate to look at annual figures. The following table compare the twelve month just before the 2001 hearing to the most current twelve month period:

SOUTHERN CALIFORNIA
MILK PRODUCTION, SHIPMENTS and PROCESSING
June 2000 to July 2001, and April 2002 to March 2003

Twelve Months Ending	Direct Shipments From Southern California	Direct Shipments from Northern California	Plant Transfers from Northern California	Shipments & Transfers from Other Source	Production Exempt from Pool	Plant Transfers **to** Northern California	**TOTAL**
July 2001	167.6	49.9	11.6	17.4	3.0	0.8	250.3
March 2003	161.5	58.7	20.6	30.8	3.0	0.7	275.1
Change	-6.1	8.8	9.0	13.3	-0.1	-0.2	24.8

In the twenty months that separate the two periods there were significant changes in Southern California. Between production increases and declining local milk supplies, Southern California needed to import about an additional 31 billion pounds of milk. The additions came from three sources: Northern California ranches (28%), Northern California plants (29%) and out-of-state (43%). The decisions from the 2001 hearing did not hinder the expansion of milk coming in from Northern California. That milk more than made up for the decline in Southern California production. All this is at odds with any contention that the "2001 hearing decision provided no real changes to warrant making additional milk supplies available in Southern California."

The hearing panel considered the following five options for the level of transportation credits from Tulare to Los Angeles et al.:

Raise Credit to 76¢.

This is the LOL proposal for credits with no shortfall. The Department has never supported a policy of no shortfall. Compared to transportation allowances, it would draw more money from the pool to move the equivalent amount of milk.

Raise Credit to 60¢

This is the CDI proposal for credits with a shortfall. Prior to 2001, this is the method used by the Department to establish credits. However, compared to transportation allowances, it would draw more money from the pool to move the equivalent amount of milk.

Keep Credit at 50¢.

This is consistent with the policy the Department used in 2001 to establish credits. Compared to transportation allowances, it would draw about the same amount of money from the pool to move the equivalent amount of milk.

Reduce Credit to 45¢.

This is similar to policy the Department used in 2001 to establish credits. Compared to transportation allowances, it would draw exactly the same amount of money from the pool to move the equivalent amount of milk, assuming the receiving plant had a 95% Class 1 utilization.

Reduce Credit to 31¢.

This is consistent with the MPC proposal. MPC wanted the credit to be set equal to the comparable allowance less the area differential (27¢). Given the panel is recommending an allowance of 58¢, then 31¢ = 58¢ less 27¢.

Currently, it cost more to move milk for comparable quantities of fortified products using credits compared to allowances. The proposals to increase the credit would only aggravate this situation. The proponents of the various proposals to increase the credits failed to address the cost comparison issue.

Absent an increase in credits, the Panel's other recommended changes for this hearing will provide economic incentives for milk to move into Southern California Class 1, 2 and 3 plants: 9¢ allowance for close in milk, addition of Riverside to the Southern California Receiving Area (both discussed above), and the providing of credits for condensed skim (discussed below). Given that Departmental data show that LOL will be a beneficiary of all three changes, the competitive situation facing the Southern California plants that depend upon the LOL shipments will be improved.

The recommendations from the Panel should restore the competitive position of Southern California processors whom depend upon plant shipments from Tulare to the same level of other Southern California Class 1, 2 and 3 processors and should enable them to be more competitive with the out of state sources.

Panel Recommendation — Make no change in the credit from Tulare to Los Angeles, Orange and Ventura.

Other Transportation Credits Issues in Southern California

LOL proposed that transportation credit for milk shipments from Tulare to San Diego and Riverside counties be 8¢ higher than the credits for milk going into Los Angeles, Orange, and Ventura counties. They stated that the 8¢ reflected the higher hauling costs associated with the further distance.

Proponents of the higher credit for these two counties also base their argument on the failure to do so will result in insufficient California milk supplies being made available to the Class 1, 2 and 3 plants that depend upon on such plant transfers from Tulare. They also cited the long term trend in Southern California (increasing number of dairy farms are leaving the Southern California area) makes the plant-to-plant movement from Tulare even more important in the future.

For the same reasons that were stated in the previous section, the Panel believes that its recommendations with respect to providing a 9¢ allowance for local milk, addition of Riverside county to the Southern California Receiving Area, and providing a transportation credit for condensed skim is sufficient to satisfy the supply needs of the Southern California plants.

CDI proposed an increase in the credit for milk from Los Angeles to other Southern California counties. This was based on their request for comparable increases for all credits into Southern California. However, as the panel is recommending against increases in the other credits, increasing this credit would give Los Angeles plants an <u>un-requested</u>, competitive advantage over their competitors.

Panel Recommendation — Make no changes neither in the credit from Tulare to Riverside and San Diego nor in the credit from Los Angeles to other Southern California counties.

Credits for Condensed Skim: Statewide

LOL proposed to establish credits for condensed skim shipped plant-to-plant from Tulare to Southern California. They argued that this would allow more options as the milk supply in Southern California continues to decline. In addition, this may complement ranch-to-plant milk movement.

The current transportation credit system includes only milk and skim shipped plant-to-plant from designated supply counties to corresponding designated deficit counties. Historically the Department has rejected credits for condensed skim. The credits were seen as a parallel to the allowances which only supplements the movement of bulk milk. However, credits are given for tailored 2-10 and 1-11 milk which contains significant volumes of condensed skim. The development of a credit for condensed skim could give Class 1 processors additional options for securing their milk supply: (1) allowances for all their milk; (2) allowances for their bulk milk and credits for their condensed skim; and (3) credits for all their milk

The panel agrees that condensed skim used in the fortification of Class 1 products should also receive the same incentives as milk and skim. However, the Panel also believes that this should befit the whole state and not just Southern California plants served from Tulare county. The panel recognizes the importance of effective movement of condensed skim used for Class 1 fortification from all designated supply counties to all designated deficit counties. Likewise this change will also assist California's fluid milk processors in the meeting of California's fluid milk standards. It is appropriate to give transportation credits geographically beyond that proposed by LOL.

There is one specific concern that the Panel has regarding its proposed credits for condensed skim. It may be possible for a plant to receive an allowance for incoming milk and then a credit for the condensed skim the leaves the plant. The Panel discussed prorating the allowance against the credit. However, it decided to monitor the situation as it unfolds.

A credit for condensed skim may complement ranch-to-plant milk movement. However, unless a significant volume of plant-to-plant milk is displace by ranch-to-plant milk with additional condensed skim moving plant-to-plant, it will increase the net cost to the pool. However, it will "incentivize" those <u>processors</u> who are supplying milk to higher value usage.

Panel Recommendation — Make condensed skim eligible for transportation credits at the same level as bulk milk from all designated supply counties to their corresponding designated deficit counties.

Discussion and Recommendations for Other Issues

Issue 1

LOL proposed to limit transportation allowances in two ways. First, it would eliminate allowances for all milk coming in from 45 Northern California counties. Second, it would lower the allowances for milk moving within Southern California.

The basic tenet of the first proposal was that sufficient milk exists in Southern California and the Southern San Joaquin Valley to supply the needs of the plants in Southern California. The basic tenet of the second proposal was that the allowances are overly generous to certain producers.

During the hearing, some witnesses expressed the opinion that the deficit between production and utilization in Southern California could be made up entirely by milk coming from Kern county. While that was true in 1992, it was not true in 2002. Over that ten years time period, Southern California utilization grew faster than production in Kern county. As shown in the following table, the small surplus (3%) that existed in 1992 had become a small deficit (7%) by 2002.

Solids Not Fat Production and Utilization
Production For Southern California and Kern County
Utilization for Southern California Only
Totals for all of 1992 and 2002 in Millions of Pounds

1992					**2002**				
Production Source			**Utilization**	**Class**	**Production Source**			**Utilization**	**Class**
			0.84	**1**				0.87	**1**
			0.01	**2**				0.01	**2**
			0.07	**3**				0.15	**3**
So. Calif.	1.33		0.06	**4a**	**So. Calif.**	1.34		0.11	**4a**
Kern	0.13		0.43	**4b**	**Kern**	0.42		0.75	**4b**
TOTALS	**1.46**		**1.41**		**TOTALS**	**1.76**		**1.89**	
Surplus		**0.05**	3%		**Deficit**		**-0.12**	-7%	

As with the current system of transportation allowances and credits, absent market signals, there will always be some inefficiency in any scheme of milk movement incentives. Also, as proponents of these limiting proposals argued in support of their other proposals dealing with Southern California, the supple of milk in Southern California is dwindling. Maintaining the current system will continue to "incentivize" those producers who are supplying milk to higher value usage. As one witness stated:

> "*. . . if milk is going to move from further distances, why should the counties be limited? If milk moves from Tulare county at a cost of 58¢ a*

hundredweight versus from Stanislaus county at a cost of 58¢ per hundredweight, there is no difference in total cost to the pool."

page 196, lines 17-22, June 4, 2003 Hearing Transcript

Issue 2

CDI proposed elimination of transportation credits for milk from Fresno and Kings county. They argued that the credit is not being used. However, the credit from Los Angeles to other Southern California counties for which CDI requested a rate increase is also not being used. At a time when many witnesses expressed concern about the milk supply into Southern California, it is not the time to limit options.

Issue 3

Hr. Horton proposed the elimination of regional quota adjusters. There was no oral testimony favoring this proposal. There was no prehearing analysis of the impact of the proposal.

Panel Recommendation —

- Maintain a single set of rates for all milk moving into Southern California, and continue to allow milk from all counties to be eligible for transportation allowances.
- Make no change in the credit from Fresno and Kings to Southern California.
- Make no changes to the regional quota adjusters.

Concluding Remarks

Assuming that the historical patterns of shipments would not have changed, had the panel's recommendations been in effect for all of 2002, the annual cost for transportation allowances would have been increased $2.11 million. Of the total, $1.95 million would have resulted from the 9¢ allowance in Southern California for close in milk. The remaining $0.16 million would have resulted from the addition of Riverside county to the Southern California receiving area. Most of the Riverside milk would have utilized the 9¢ rate. To the extent that the new rate and the addition of Riverside county result in more milk shipped local and less milk coming in from the Southern San Joaquin Valley, these estimates may be overstated.

Had the panel's recommendations been in effect for all of 2002, the annual cost for transportation credits would have increased about a quarter million dollars. Because condensed skim has never been eligible for credits before, there may easily be a substantial increase in eligible shipments of condensed skim. To the extent this happens, the estimate may be highly understated. However, this may be offset by possible reductions in credits for bulk milk.

For both allowances and credits, these estimates of the impacts of the proposed changes are based on historic data. The past is not necessarily a good predictor of the future. This is especially true here. If the Secretary adopts the Panels recommendations, the Panel expects there will be major changes in the patterns of the movement for both milk and condensed skim. The static analysis and the expectation of change are rough. However, it is the best analysis of the potential impact that the Panel can provide

After reviewing all of the matters during the process of developing this report, the Panel is more aware than ever that all of the regulations encompassed by the milk movement incentive program are linked. Changing one regulation necessarily has a ripple effect and affects other milk movement regulations directly or indirectly.

The Panel notes that individual interests appeared to dictate the types and scopes of proposals submitted and the positions taken in the matters affecting milk movement incentives. The Panel recommends moving forward on milk movement incentive policy and cites three basic criteria as guidelines — most efficient milk movements promoted or "incentivized", encourage the closest milk to Class 1 plants to move first, and minimize costs to the pool. The Panel was disappointed in the lack of testimony or evidence submitted into the hearing record that dealt directly with these three basic criteria. The Panel sees a need for more focus on the long term implications of changes and exhorts the industry to work toward a solution that is in the best interest of the industry and of the public.

Unaddressed Issues

In analyzing the data relevant to the hearing proposals, the Panel found there were some issues that were not addressed at the hearing including, but not necessarily limited to, the following:

- The 43¢ and 58¢ allowances for milk moving into Southern California appear to be appropriate, respectively, for central Kern county and central Tulare county. However, the 15¢ jump at 140 miles appears to favor southern Tulare county over northern Kern county.

- The panel has suggested several changes that address the declining milk supply in Southern California: addition of Riverside county, 9¢ allowance for local milk, credit for condensed skim. However while Class 1, 2 and 3 plants in the Northern California counties of Marin and Sonoma face a similar situation of a declining milk supply, these plants have no allowances or credits.

- A proposal to eliminate Regional Quota Adjusters (RQA) was made at the hearing, but the proposal was not actively supported. As a result, there was no general discussion of this issue. However as the Department stated at the end of its RQA background paper (Hearing Exhibit #7f):

  > "The California dairy industry is significantly different today than it was in 1969 when pooling became effective, than it was in 1983 when RQA's were adopted, or than it was in 1994 when the $1.70 was adopted. The industry will have to decide if RQA's were needed merely for a transition period to '*minimize the adverse and destabilizing effects of a change'*, or if RQA's are needed to permanently '*lower the quota price in areas distant from deficit markets'.*"

The Panel needs more testimony and input from interested parties before these issues can be addressed.

Submitted July 9, 2003

ATTACHMENT A–1

Summary of Panel Recommendation

Recommendation: Do not adopt a uniform transportation allowance system statewide.

Arguments in favor:

1. Milk markets tend to be unique and are too dissimilar to implement successfully a "one–size–fits–all" transportation allowance template.
2. Implementation of a uniform transportation allowance system may provide financial incentives to move milk to higher usage plants where none is needed.
3. Implementation of a uniform transportation allowance system may lead to unequal raw product costs among Class 1 handlers.

Arguments opposed:

1. Failure to implement a uniform transportation allowance system perpetuates a system that some producers view as inequitable.
2. Not all producers who ship to qualifying plants will be "incentivized" identically.
3. Only select plants, i.e., those that meet the minimum qualification standards and are located in designated deficit areas, will be able to use transportation allowances to attract milk.

Recommendation: Increase the rate for milk in the 0 to 89 mile bracket in the Southern California and San Diego Receiving Areas from $0.00 to $0.09 per hundredweight with no further changes to the remaining mileage brackets and rates.

Arguments in favor:

1. With milk production in Southern California decreasing significantly, incentives are needed to move local milk to higher–valued usage plants.
2. Encouraging locally produced milk to move into Class 1, 2 and 3 plants is consistent with the regulatory goal of efficient movement of milk.
3. Movement of local milk to higher–valued usage plants may decrease the cost of transportation allowances by limiting the amount of milk being shipped from the South Valley into Southern California Class 1, 2 and 3 plants.

Arguments opposed:

1. Implementing a transportation allowance for milk located less than 89 miles from qualifying plants in Southern California may not actually change milk movement patterns. As such, the goals of efficiency and minimization of costs to the pool may not be achieved.

2. Implementing a transportation allowance for milk located less than 89 miles from qualifying plants in Southern California is more government regulation that draws money from all producers to address a problem that is evident only in Southern California.
3. No plant in Southern California has not received adequate supplies of milk; the current marketing conditions, farm and regulatory structures appear to be functioning appropriately.

Recommendation: Extend transportation allowances to qualifying plants in Riverside County by including Riverside County in the Southern California Receiving Area.

Arguments in favor:

1. With milk production in Southern California decreasing significantly, incentives are needed to move local milk to higher–valued usage plants.
2. Encouraging locally produced milk to move into Class 1, 2 and 3 plants is consistent with the regulatory goal of efficient movement of milk.
3. Movement of local milk to higher–valued usage plants may decrease the cost of transportation allowances by limiting the amount of milk being shipped from the South Valley into Southern California Class 1, 2 and 3 plants.
4. Riverside County has been eligible for transportation credits for years. The addition of Riverside County to the Southern California Receiving Area affords the Class 1, 2 and 3 plants operating in Riverside County another means of obtaining a portion of their milk supply at competitive costs.

Arguments opposed:

1. Including Riverside County in the Southern California Receiving Area (and implementing a transportation allowance for milk located less than 89 miles from qualifying plants) may not actually change milk movement patterns. As such, the goals of efficiency and minimization of costs to the pool may not be achieved.
2. Including Riverside County in the Southern California Receiving Area (and implementing a transportation allowance for milk located less than 89 miles from qualifying plants) adds more government regulation and complexity to an already esoteric system. Money will be drawn from all producers to address a problem that is evident only in Southern California.
3. No plant in Riverside County has not received adequate supplies of milk; the current marketing conditions, farm and regulatory structures appear to be functioning appropriately.

Recommendation: Do not make any changes to the transportation allowance system in the Bay Area and Solano Receiving Areas.

Arguments in favor:

1. The transportation allowance increases requested were not verifiable using Departmental hauling cost data.
2. The cost data that were submitted into the hearing record by the requesting organizations were insufficient to compel the Panel to grant the increase in transportation allowances.
3. The two proposals were not available prior to the date of the hearing. Other Northern California processing plants that were not informed of the proposals until the date of the hearing will not be affected by granting the requested transportation allowance increases.
4. The established procedures that are in place to ensure a complete hearing record were not adhered to when the transportation allowance increases were requested. By denying the request, the Panel does not have to go outside the bounds of the procedures that govern the hearing process to approve requests that may or may not have merit.

Arguments opposed:

1. While the requests for increases in transportation allowances may not have followed the established hearing procedures precisely, the parties made reasonable requests with at least some cost data to substantiate their requests.
2. Not granting the requested transportation allowance increases merely puts more cost pressure on affected dairy producers when milk prices are already at historic and sustained lows.
3. The fact that other processing plants in Northern California may be affected indirectly by granting the requested transportation allowance increases is not relevant. Other processing plants were free to request additional transportation allowances at the hearing.

Recommendation: Make no change to the transportation credit from Tulare County to Los Angeles, Orange and Ventura Counties.

Arguments in favor:

1. By not granting the request to increase transportation credits from Tulare to Southern California counties, the Panel underscores its desired relationship of transportation credits vis-à-vis transportation allowances. That is to say, the costs of moving milk by either system ought to be comparable.
2. By not granting the request to increase transportation credits from Tulare to Southern California counties, the existing competitive relationship among plants that supply milk to Southern California will remain unchanged.
3. The implementation of a transportation allowance for local milk in Southern California should encourage milk to move efficiently within Southern California and decrease the industry’s dependence on the transportation credit system.
4. The producer community has no explicit nor implied responsibility to subsidize the cost of the second haul, i.e., the cost of moving milk from plant to plant.

Arguments opposed:

1. The requested increases in transportation credits were supported by cost data submitted into the hearing record.
1. Milk moving out of Tulare into designated deficit areas in Southern California serves the Class 1 market. The fact that the Southern California Class 1 plants could be served more efficiently by milk located closer to the plants is not relevant. The plants that serve the Class 1 market ought to be properly "incentivized" for the service that is being provided.
2. Not granting the requested transportation credit increases merely puts more pressure on Southern California Class 1 plants to find other sources of competitively priced milk.

Recommendation: Make no changes to the transportation credit from Tulare to Riverside and San Diego Counties nor to the transportation credit from Los Angeles to other Southern California Counties.

Arguments in favor:

1. Granting increases in transportation credits for these other areas after denying the request to increase transportation credits from Tulare County to Southern California would give plants in the affected areas a significant financial advantage over their competitors. The existing competitive relationship among plants that supply milk to Southern California will remain unchanged.
2. By not granting the request to increase transportation credits, the Panel underscores its desired relationship of transportation credits vis-à-vis transportation allowances. That is to say, the costs of moving milk by either system ought to be comparable.
3. The implementation of a transportation allowance for local milk in Southern California should encourage milk to move efficiently within Southern California and decrease the industry's dependence on the transportation credit system.
4. The producer community has no explicit nor implied responsibility to subsidize the cost of the second haul, i.e., the cost of moving milk from plant to plant.

Arguments opposed:

1. The requested increases in transportation credits were supported, at least in part, by cost data submitted into the hearing record.
2. Milk moving into Class 1 plants in Designated Deficit Areas in Southern California serves the fluid milk market. The fact that the Southern California Class 1 plants could be served more efficiently by milk located closer to the plants is not relevant. The plants that serve the Class 1 market ought to be properly "incentivized" for the service that is being provided.
3. Not granting the requested transportation credit increases merely puts more pressure on Southern California Class 1 plants to find other sources of competitively priced milk.

Recommendation: Make condensed skim eligible for transportation credits at the same level as bulk milk from all designated supply counties to their corresponding designated deficit counties.

Arguments in favor:

1. Granting transportation credits for condensed skim may give Class 1 plants in all designated deficit counties more options for obtaining the milk components necessary for processing packaged products that meet California fluid milk standards.
2. Facilitating the movement of condensed milk to Class 1 plants is consistent with the implied goals of government regulation in the dairy industry, regardless of what the original intent of the transportation credit system was when it was established.

Arguments opposed:

1. Condensed skim has not been previously eligible for transportation credits because the transportation credits system was supposed to mirror, as closely as possible, the transportation allowance system. Testimony submitted into the hearing record was inadequate to make such a radical change in existing policy.
2. Allowing condensed skim to be eligible for transportation credits may only cost dairy producers more money out of the pool without increasing the efficiency of the system by changing existing milk movement patterns.
3. Granting transportation credits for condensed milk may increase the industry's dependence on the transportation credit system.
4. The producer community has no explicit nor implied responsibility to subsidize the cost of the second haul, i.e., the cost of moving condensed skim from plant to plant.
5. Without putting further restrictions on granting transportation credits for condensed skim, some "double–dipping" may occur. It will be possible for plants to attract ranch milk using the transportation allowance system and then receive transportation credits for condensed skim shipped to qualifying Class 1 plants.

HEARING TESTIMONY

LAND O' LAKES

- Increase in transportation credit from 50 to 66¢ per hundredweight for milk plant-to-plant from Tulare county to Los Angeles, Orange, and Ventura counties.
- Increase transportation credit from 50 to 74¢ per hundredweight for milk moving from Tulare county to Riverside and San Diego counties.
- Establish transportation credit for condensed skim of 72¢ per cwt for condensed skim moving from Tulare county to Los Angeles, Orange, and Ventura counties; 80¢ per cwt from Tulare county to Riverside and San Diego counties.
- Expand the transportation allowance to Riverside county
- Transportation allowances for over 89 miles:
    - From Santa Barbara, San Diego, Imperial, Kern, Kings, and Tulare counties to Los Angeles, Orange, Ventura, and Riverside: $0.43 per cwt (over 139 miles, $0.58 per cwt)
    - From Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino and Ventura to San Diego, $0.12 per hundredweight.
    - From remaining 45 Northern California counties, no allowance
- To maintain equal raw product costs for California fluid milk operations, necessary to update the transportation credit to reflect cost of moving milk from Tulare plant into Southern California.
- Currently, there is a shortfall of milk moved from plant-to-plant from Tulare to Riverside Co.
- Land O' Lakes cannot compete as a supplier of milk with the current transportation credit system
- Almost twice as much milk being shipped into California from out-of-state sources than there is being supplied on a plant transfer basis in California
- For May 2002, 6.5¢ per cwt was the effect of out-of-state milk on the pool, totaling $19 million for the year 2002.
- Land O' Lakes cannot compete with other in-state suppliers of condensed skim, without the proposed transportation credits
- Does not agree with the Milk Producers Council proposal

MILK PRODUCERS COUNCIL

- Agrees with the principle that the closest milk to the market ought to move first and that any regulated system out to minimize costs to the pool.
- Only Class 1 milk in California should qualify for transportation incentives.
- All Class 1 milk in California should qualify for transportation incentives.

- All California Grade A milk production is eligible.
- Combination of the area differential and transportation credit shall not exceed the applicable transportation allowance for the distance the milk travels.
- Land O' Lakes proposal does not reward producers who serve the Class 1 market and does nothing to encourage the closest milk to move first to the Class 1 market.

DAIRY INSTITUTE OF CALIFORNIA

- Transportation allowances rates should be set equal to the difference between the cost of the local haul and the cost of the haul to higher-use plants in metropolitan markets.
- Supports the adjustments to the allowances as proposed by Land O' Lakes.
- Sees no reason to exclude Fresno county from the eligible supply county for allowances.
- Opposes the Milk Producers Council proposal with respect to transportation and credit allowances.
- Supports Land O' Lakes proposed transportation credit adjustments.
- Opposes the extension of credits to condensed skim.
- Continues to support the RQAs.

CALIFORNIA DAIRIES, INC.

- 10% decline in Southern California production in the past year and expect to lose additional 15% in next 12 months.
- Oppose the Milk Producers Council proposal, especially since it would eliminate the Artesia plant from eligibility for allowances.
- Support the changes in eligible counties and rate changes of the Land O' Lakes proposal.
- Propose Northern California transportation allowances (+$0.04 adjustment): For plants in Bay Area receiving area, from 0-99 miles $0.28 per hundredweight; over 99 miles through 199 miles, $0.32 per hundredweight; over 199 miles, $0.34 per hundredweight.
- Oppose the extension of credits to condensed skim.
- Remove Fresno and Kings counties as designated counties for credits.
- Agrees with transportation allowances to Southern California.
- Differences from Land O' Lakes proposals on transportation credits: increase of $0.10 from Southern California to Southern California; increase of $0.10 from South Valley to Los Angeles, Orange and Ventura; and increase $0.18 from South Valley to Riverside, San Diego.

SWISS DAIRY

- Supports the Dairy Institute proposal.
- Milk supplies from the South Valley are necessary for the Class 1 plants in Southern California.
- Land O' Lakes proposal would promote equal raw product costs for Swiss Dairy and we would be competitive in sale of Class 1 products.

- Oppose the extension of credits to condensed skim.
- Plant-to-plant movement of milk minimizes back hauling of cream to the valley.
- Our plant was designed to accommodate the fluid milk standards by purchasing standardized milk on a plant-to-plant basis from the South Valley – we pay a service charge for the production of the standardized milk. For Swiss Dairy to receive only producer milk would require a major capital investment.
- Oppose the Milk Producers Council proposal.

WESTERN UNITED DAIRYMEN

- Feels that Southern California has ample milk to fill its Class 1 needs.
- If milk must move from to Southern California from distant locations to serve Class 1 needs, all counties should be eligible.
- Supports the addition of Riverside Co. as a receiving area for allowances in Southern California.
- Would not support Milk Producers Council proposal that only Class 1 milk would be eligible for transportation allowances.
- Oppose Milk Producers Council proposal for a statewide Class 1 allowance.
- Oppose the Land O' Lakes proposed transportation credits – feel it would favor plant-to-plant movement over ranch-to-plant movement.
- Oppose the Milk Producer Council statewide transportation credit – it ignores the distinct differences of the northern and southern areas of California.
- Oppose the extension of credits to condensed skim.

DRIFTWOOD DAIRY

- Support the extension of credits to condensed skim.
- Plant-to-plant movement of milk from South Valley to Southern California is just as efficient if not more so, than ranch-to-plant from the Valley to Southern California.
- Support Land O' Lakes proposal of additional $0.16¢ per cwt transportation credit from South Valley to Los Angeles, Orange and Ventura counties

CRYSTAL CREAM and BUTTER COMPANY

- Opposes Milk Producers Council proposal that only Class 1 would be eligible for allowances.
- Oppose any proposal that favors cooperative over independent supply arrangements.
- Supports the Dairy Institute of California testimony given at this hearing.
- Support allowing other classes of milk to be covered for allowances – usage fluctuates throughout the year based on produce demand.
- Support including deficit supply area as a criterion for transportation allowances.
- Supports maintenance of the current rates and qualifying criteria.

LETTERS SUBMITTED AS HEARING EXHIBITS

- Joe Maruca, Chairman, Imperial County Board of Supervisors – In support of continuing current transportation allowances for Imperial county producers. Eliminating or reducing the allowances would place Imperial county producers at a competitive disadvantage in selling to deficit area plants. The trend of producers is to relocate away from urbanized areas of Southern California so as this occurs, milk will need to be transported greater distances.
- Ed McGrew, Nudairy One –Nudairy One is a dairy development firm. Mr. McGrew is a member of the Imperial Valley Dairy Attraction Committee. This committee is in support of retaining the transportation allowances at the current level. Elimination of the allowances would discourage producers from relocating dairies into Imperial county and could possibly affect producers' decision to stay in California.

- Robert Horton, public citizen – Mr. Horton, retired Milk Pooling Branch Chief, suggests the elimination of the Regional Quota Adjuster system entirely and providing Southern California producers a transportation allowance when shipping to Class 1, 2 and 3 plants.

- Paul W. Bikowitz, President, Santee Dairies, Inc. – Santee Dairies, Inc. is a fluid milk processing plant located in City of Industry. In order to stay within a competitive posture, Santee supports an increase in transportation credits from South Valley to Southern California, as well as making condensed skim eligible for transportation credits.

- Stephen L. Birdsall, Imperial County Agricultural Commissioner – In support of continuing the current transportation allowances in order to move milk from Imperial county to deficit areas, thereby keeping Imperial county dairies competitive with dairies geographically located closer to processing plants.

- Gary Stueve, Western Region Vice-President, Dairy Marketing Services
  - In support of LOL's proposed changes including Riverside county in Southern California receiving area.
  - Opposes LOL's proposal to re-establish a system of supply counties that would qualify for transportation allowances. All California Grade A ranch milk should qualify for TA's. They system of mileage brackets, transportation allowances rates and actual freight costs will determine the feasibility of moving milk to a qualifying plant.
  - Opposes MPC's request to change the rules of plant eligibility for transportation allowances. The production of non-Class 1 products is often complementary to Class 1 production, using components left over from bottling reduced and nonfat milks. By restricting the TA's based on end utilization, a plant with significant Class 1 volume, but with some complementary non-Class 1 volume, could have difficulty attracting milk.

POST HEARING BRIEFS

LAND O' LAKES

- Only major testimony in opposition to Land O' Lakes was from Milk Producers Council and Western United Dairymen.
- The transportation credit system only represents a fraction of the cost represented by the cost to the pool for out-of-state milk.
- California sources of milk need to be more competitive with out-of-state sources.

MILK PRODUCERS COUNCIL

- Higher producer-paid subsidiaries for plant-to-plant movement are not appropriate – encourage inefficient milk movement.
- Agree with much of Dairy Institute's testimony on not limiting the coverage to Class 1 only – we now propose to eliminate all Class 4a and 4b milk from allowance eligibility.
- We agree with CDI's statement that a time is coming when Tulare county milk will not be needed to supply the Southern California Class 1 market.

DAIRY INSTITUTE OF CALIFORNIA

- Support 50% usage in Class 1, 2, and 3 to be appropriate standards for allowances.
- Class 2 and 3 usages contribute more money to the pool than alternative uses, such as Class 4a.
- Allowance and credit rates must be set at levels sufficient to encourage the movement of milk.
- A plant's willingness to pay for "tailored milk" depends on the characteristics of the plant's operation and specific market it is designed to serve.

CALIFORNIA DAIRIES INC.

- Submitted hauling costs from Marin county producers to the Bay Area.
- Removal of allowances from Fresno county north to So California will increase producer pool revenues because if this milk is not "incentivized", the equivalent amount of milk will come from no further than Kern county which costs less to move.

SWISS DAIRY

- Surplus milk must move out of the Las Vegas region for processing – excess milk supplies from Southern Nevada are being shipped into California where they compete with California-produced milk – thus diluting the value of the milk revenue pool for California dairymen.
- The new Dean plant in Clark County, Nevada, will better serve the Las Vegas market and utilize existing milk supply located there.

DAIRY FARMERS OF AMERICA WESTERN AREA COUNCIL

- Supports CDI’s proposed $0.04 cent adjustment to Northern California Bay Area allowance.

CRYSTAL CREAM and BUTTER COMPANY

- Combination of equal haul rates for close to mid-distance dairies and attractive alternative buyers provides adequate justification for retention of transportation allowances starting at “0” miles from Sacramento deficit area.
- Ask the Department not to act on the $0.04 cent increase in allowance for No. California receiving areas – did not have the data needed to make an analysis on this issue.